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APR 12 1996

FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of	)	
	)	CC Docket No. 96-45
Federal-State Joint Board on Universal Service	)	

Comments of Time Warner Communications Holdings, Inc.

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Summary

As a competing provider of local exchange service, TW Comm is committed both to supporting and expanding the availability of affordable basic telephone service in all parts of the nation and to all citizens. In order to meet the goals enumerated in Sections 254 and 214 of the 1996 Act, however, the current mechanisms for funding universal service must be revised. Put simply, the current system relies too heavily on local exchange carrier ("LEC") reported costs. These costs are inflated and do not portray the actual costs necessary to provide local exchange services with any accuracy. To determine universal service support for high cost areas, the Commission must adopt an objective approach. The primary focus of such an objective approach should be the user, rather than the service provider. Further, an objective approach will ensure that the approach actually supports and promotes universal affordability of basic telephone services and does not merely provide one more opportunity for financial assistance to support LEC revenue requirements.

In determining whether a particular area qualifies for high cost support, an affordability benchmark should be determined and not until local rates exceed the benchmark should an area be deemed eligible for support. In determining the amount of support needed to efficiently serve the area, the Commission should implement a cost proxy model to calculate the costs of serving the area. Once the costs of serving an area have been determined, a competitive bid should be conducted to ensure that

services are being provided to customers in the most efficient manner and at the least possible cost.

The responsibility of funding universal services must be equitably allocated. However, before this can be accomplished the non-targeted support mechanisms that currently exist must be eliminated. To the extent targeted support is necessary, it should be based upon a value added assessment of all industry participants.

TW Comm supports providing schools, libraries and health care providers with access to basic and advanced telecommunications services; however, answers to the questions raised in this proceeding cannot be properly answered until more information has been gathered. The Commission should thus initiate a separate Notice of Inquiry proceeding to acquire the requisite information that will enable parties to properly and informatively comment on these very important issues.

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Introduction

Time Warner Communications Holdings, Inc.[1] ("TW Comm") hereby files its comments in response to the Federal Communications Commission's ("Commission" or "FCC") Notice of Proposed Rulemaking ("NPRM")[2] implementing Section 254 of Communications Act of 1934, as added by the Telecommunications Act of 1996 ("1996 Act" or "Act").[3]

These comments focus on the following: (I) procedural matters relating to the page limitation in this proceeding; (II) support for rural, insular, and high cost areas and low-income customers; (III) universal service principles related to schools, libraries and health care providers; and (IV) universal service support mechanisms.

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1 A wholly-owned subsidiary of the Time Warner Entertainment Company, L.P.

2 In re Federal-State Joint Board on Universal Service, Notice of Proposed Rulemaking and Order Establishing Joint Board, CC Docket No. 96-45, FCC 96-93 (released March 8, 1996) (hereinafter "NPRM").

3 Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996)(to be codified at 47 U.S.C. § § 151 et seq.) (hereinafter "1996 Act").

I. **Procedural Matters**

Due to statutory time limits placed upon the Commission's efforts to implement the directives of the 1996 Act, the Commission has imposed a page limitation in this proceeding in order to streamline its rulemaking proceedings. In this instance, however, the magnitude and importance of the rulemaking proceeding requires the submission of detailed information and analysis. This is not a proceeding initiated to air broad policy questions for general response. In fact, in this proceeding very specific issues need to be addressed that will ultimately impact not only telecommunications service providers but customers as well. The detailed analysis necessary to assist the Commission in its efforts to reach reasoned conclusions about universal service cannot be fully developed in a 25 page piece.

The 25 page limitation for responses to over 60 pages of questions in the NPRM unnecessarily adds arbitrariness to the proceeding. The page limitation may slow the progress of achieving the goals set forth by Congress and may, in fact, prevent these goals from being met at all. To provide the Commission with a more comprehensive statement on the issue of universal service, TW Comm is attaching to its comments a copy of its white paper, entitled Funding Universal Service: Maximizing Penetration and Efficiency in a Competitive Local Service Environment, to provide further support for the material discussed in its comments.

II. Support for Rural, Insular, and High Cost Areas and Low-Income Consumers

The NPRM seeks comment on the design and operation of the support mechanism for rural, insular, and high cost areas as well as for low-income consumers.[4] Principles enumerated in Section 254 of the Act provide the Commission with some instruction on how to design and operate the support mechanism for rural, insular, and high cost areas as well as for low-income customers. Part A of this section will provide the Commission with further guidance regarding support for rural, insular, and high cost areas. The following portion of this section, B, will assist the Commission in its consideration of support for low-income consumers.

A. Support for Rural and High Cost Areas

The Commission must take a number of steps to ensure that support for rural and high cost areas is achieved in the most effective manner. First, the Commission must decide on a precise definition for the term, "basic services". Second, the Commission must ensure that services provided within a certain area satisfy the affordability provision of Section 254(i).

1. The Precise Definition for Basic Services

The first step the Commission must take to establish a universal service policy is to define the scope of the basic services that should be provided on a ubiquitous basis. It is vital for this definition to be accurate. An overly narrow definition of basic services may leave customers in rural,

[4] NPRM, para. 14.

insular and high cost areas, as well as low-income customers, without basic telecommunications services. On the other hand, an overly broad definition of basic services may cause the required support level to be greatly inflated.[5]

The following five "core" services, enumerated in the NPRM, should be designated as basic services for purposes of universal support: (1) voice grade access to the public switched network, with the ability to place and receive calls;[6] (2) tone dialing; (3) single party service; (4) access to emergency services (911); and (5) access to operator services.

It would also be appropriate to include some base level of local usage within the definition of basic service, as the ability to place local calls is equally, if not more, important than the ability to receive calls.[7] Relay services and a directory listing should also be encompassed within the scope of the basic universal service definition.

2. Affordability of Basic Local Telephone Rates

Section 254(i) of the 1996 Act requires the Commission and the States to ensure that telecommunications service rates throughout the country are "just, reasonable and affordable". In contrast, the Communications Act of 1934 required that rates for

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[5] This is undesirable because it is likely that an inflated subsidy requirement will be burdensome to new entrants and thus will hinder the development of competition.

[6] Such access should include access to directory assistance and interexchange carriers.[6]

[7] This does not imply that flat rate service is a universal service requirement. Measured service packages with certain call allowances would meet such a requirement.

telephone services be just and reasonable without unjust or unreasonable discrimination but did not expressly require that rates be affordable.[8] Accordingly, the NPRM seeks comment on how the addition of the affordability criterion to its underlying statutory authority changes the nature of the Commission's universal service goals and their implementation.

The most effective way to assure the affordability of telephone service is through competition. The presence of healthy competition in the marketplace will assure the lowest, most efficient price for basic service as well as expand the scope of available services and capabilities by improving the overall efficiency with which such services are provided. Thus, competition in the telecommunications market is an essential element of an effective universal service policy. Most markets, however, do not yet face competition. Therefore, state and federal regulators must make the initial determination as to what constitutes affordable service despite the fact that there is no generally accepted standard for determining "affordability" or for measuring the degree to which this aspect of the 1996 Act's requirement is (or is not) being satisfied.

The price of basic residential telephone service, expressed in real terms, has been declining steadily for many years. Beginning in 1989, the year in which the residential Subscriber Line Charge ("SLC") transition was completed, basic residential rates decreased by approximately two percent annually through

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8 47 U.S.C. §§ 201-202.

1993.[9] At the same time, residential penetration rates have increased steadily.[10] The high rate of acceptance of prevailing prices and the high rate of demand for basic access confirm that the prevailing price levels and pricing policies in affect today across state jurisdictions are indisputably within the "affordability" range. Nor is there any reason to expect that modest amounts of rate rebalancing towards cost will affect subscribership levels. FCC tracking reports confirm that residential penetration rates have been virtually unaffected by such landmark events and policy initiatives as the break-up of the former Bell System, the introduction of CPE and long-distance competition, and the transition to the current $3.50 SLC. Moreover, as the experience in Massachusetts demonstrates, a carefully considered rebalancing of rates with their underlying costs will not jeopardize the achievement of universal service.[11] Finally, the continuation of existing low-cost "lifeline" services will act as a safety net for low-income consumers for whom telephone service is not affordable.[12]

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9 FCC Common Carrier Bureau, Trends in Telephone Service, February 1995, Table 5.

10 Id., Table 2.

11 In Massachusetts, state regulators found that there had been no statistically significant change in telephone service penetration rates in the years 1989 to 1992 as residential rates were increased toward cost. Thus, the transition to cost-based rates did not negatively impacted universal service. The current proposed increase is unlikely to have an adverse impact on universal service. Massachusetts D.P.U. 93-125, NYNEX, January 13, 1994, at 58.

12 With the existence of lifeline services, factors other than price need to be considered in getting and keeping individual subscribers on the network. See Infra Section II.B.1.

a. Affordability can be accomplished by maintaining an "affordability benchmark"

The affordability of local telephone rates can be accomplished by defining and maintaining an "affordability benchmark" that would be used to establish the maximum rate that an average residential subscriber would be required to pay. The affordability benchmark would represent the upper end of the range of total charges for local services that individual residential subscribers in a state must pay without support.[13] Service would thus be deemed affordable if the price is at or below the highest rate level applicable for any exchange within a given jurisdiction for which residential penetration is within five percentage points of the jurisdiction-wide average.

Initially, the benchmark would be determined by identifying the highest rate being charged by the incumbent LEC. If the per-line cost of serving an exchange exceeds the affordability benchmark, customers would be charged the benchmark rate, and the excess would be drawn from the universal service fund ("USF"). Thus, high cost support will be provided only in those exchanges where it has been determined that local service rates will exceed the benchmark.

b. Competition will drive prices toward cost

As competition emerges in high cost markets, overall costs for local services will probably decline. A competitive local market will stimulate efficient behavior and will drive down

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[13] Affordability would be measured over a "basket" of services representing the average demand by residential subscribers. The relationship between affordability and the range of ancillary services demanded by customers should not be ignored.

costs, thus bringing local service rates closer to or below the benchmark. As rates move closer to the benchmark, the amount of required support will be reduced and ultimately eliminated as rates fall below the benchmark. Moreover, competition will encourage greater efficiencies among the LECs and offer business and residential consumers choices among alternative providers. Finally, competition and the efficiencies it will engender will reduce the ongoing need for any general support of residential services.

3. Calculating the Support Level

The Commission seeks comment on methods for determining the level of support required to ensure that carriers are financially able to provide services identified for inclusion among the services to be supported by universal service funds in rural, insular, and high cost areas.[14] The Commission emphasized that the method adopted must be: (i) simple to administer, (ii) technology-neutral, and (iii) designed to identify the minimum subsidy required to achieve the statutory goal of affordable and reasonable, comparable rates throughout the country.[15]

Under the present high cost system, the Commission relies upon LEC reported costs to determine whether a particular area requires universal service support. However, relying on LEC reported costs defers to a large extent to unverifiable LEC-created "cost of service" studies. It is unlikely that LEC reported costs accurately reflect the actual costs associated

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[14] NPRM, paras. 27 - 39.

[15] Id.

with serving a particular area. Further, under this system, there is little or no incentive for LECs to control or reduce their expenses. Thus, distributing high cost assistance based on LECs' actual reported costs perpetuates the existing inefficiencies and unnecessary expenditures in monopoly markets.

TW Comm suggests that the independent and objective identification of high cost areas is best achieved by implementing a cost proxy model to determine the cost levels for the area and a competitive bidding process to determine the fair market value of serving the area.

a. **Objective analysis and cost proxy approach**

The NPRM recognizes the value of implementing a cost proxy model to determine the level of subsidy required to bring services priced at affordable levels to consumers in high cost areas. TW Comm supports the Commission's tentative conclusion that if properly structured, a cost proxy approach would be a more effective way to determine assistance than the current approach. An objective assessment of the costs of serving "allegedly" high cost areas can be accomplished through the development of standardized cost proxies. These standardized cost proxies should be based upon an analysis of threshold attributes that have nothing to do with the provider of the service but rather deal with the unique, independently verifiable physical characteristics of the area in question.

The comments submitted by the National Cable Television Association ("NCTA") in this proceeding will provide a more detailed discussion on an effective cost proxy model. TW Comm subscribes to and supports the comments on effective cost proxy models contained in the NCTA comments.

b. **Bidding process**

To calculate the level of subsidy necessary to serve a high cost area, the cost proxy approach should be used in conjunction with a competitive bidding process. The NPRM seeks comment on the effectiveness of utilizing a competitive bidding process to set the level of the subsidy in rural, insular and high cost areas.[16] Once an area has been designated for high cost support, the particular area would then be put out to bid. The incumbent LEC and any other certificated local exchange service provider wishing to participate could submit bids.[17] The purpose of implementing competitive bidding for high cost support is to ensure that these areas are served in the most economically efficient manner possible. Without competitive bidding, these assurances may not be met.

TW Comm's White Paper, written prior to the 1996 Act, supports a bidding process that awards the lowest bidder exclusive high cost support for a particular area. This position, however, is inconsistent with the 1996 Act which states that "the State commission shall designate more than one carrier as an eligible telecommunications carrier for a service area designated by the State commission . . ."[18] Although an

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[16] Id. para. 35.

[17] The cost proxies would establish a ceiling amount for high cost support in case the incumbent is the only carrier bidding for the market.

[18] 1996 Act sec. 102(a), § 214(a)(2).

exclusive support mechanism appears to be precluded by the new regulatory regime, it would have provided bidders with the greatest incentive to bid efficiently, ensuring that support would be provided at the least cost. Absent such an alternative, it is imperative that the Commission implement a bidding mechanism that will provide a similar incentive. Without an incentive to encourage low bids, there would be no assurance that service would be provided in the most efficient manner possible.

The NPRM recognizes the importance of an "incentive bonus"[19] that will serve to induce competitors to underbid one another. However, the NPRM does not specify the type of incentive to be provided. One option may be to establish a bidding process whereby the lowest bidder would receive 100 percent high cost support while all other bidders would receive a smaller percentage of support. This incentive bonus would encourage carriers to submit low bids, since the lowest bidder would be ensured full universal support, while allowing more than one eligible telecommunications carrier to receive high cost support consistent with the 1996 Act.

4. Only LECs Subject to Rate of Return Regulation Should be Eligible for Support

Regulators should be skeptical of LEC claims for high cost support. Universal support for high cost areas should not be made available to incumbent LECs that are no longer subject to traditional Rate of Return Regulation ("RORR"). Incentive regulation provides regulated entities with both the tools and

[19] NPRM, para 36.

the opportunities to respond to and mitigate the financial impact of competition. Thus, service providers subject to incentive regulation are expected to accept and anticipate certain risks and costs that companies subject to RORR have been insulated from.

Pricing flexibility for the range of service offerings, the ease of offering new services, and significantly increased earnings opportunities are the LECs' principal tools in combatting competition and in internally funding high cost universal service obligations.[20] While incentive regulation provides the opportunity for increased earnings, universal service support should not be a vehicle to guarantee increased earnings. Therefore, because these opportunities are available to LECs subject to incentive regulation, only LECs subject to RORR should be eligible to draw funds for individual high cost areas.

B. Support for Low-Income Consumers

In order to provide the required support for low-income customers, the Commission must determine the following: (1) what services should be included in support for low-income customers and (2) how that support should be implemented, i.e. who is eligible for the support and how that support should be distributed.

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[20] In addition, the 1996 Act has provided BOCs with entry into new lines of business as further sources of revenue growth.

1. What Services to Support

TW Comm concurs with the NPRM's tentative conclusion that the services supported by federal universal service funds for rural, insular, and high cost areas should also be provided to low-income consumers.[21] In fact, in order to improve subscribership levels among low-income consumers, it may be advisable to offer additional services to these consumers. By implementing support mechanisms that will target low-income households, the principles enumerated in the 1996 Act will be more readily achieved.

a. Toll blocking services may be an appropriate service to offer low-income consumers

Voluntary toll blocking services may be an effective method of improving subscribership levels among low-income households. The inability to control long-distance usage is a major cause of disconnection of telephone services among low-income subscribers. Once a subscriber has been disconnected, reconnection becomes a formidable obstacle by virtue of the charges associated with reconnecting the service. Thus, a voluntary long-distance blocking service would provide consumers with greater control over the use of their telecommunications services, as well as protect low-income consumers from incurring charges that they may not be able to pay, non-payment of which could ultimately result in disconnection from the network.

Services that simply restrict the use of long-distance services to certain allotted amounts of time, however, should not

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[21] NPRM, para. 50.

be included among the universal service supported services. Toll limitation services tend to be more expensive to provide and administer than toll blocking services. Furthermore, the capability to offer such services may vary by switching technology and billing systems.

The following practical limitations must be considered: how customers will track their use in order to determine when they are near their allotted time limit and also how the service provider will react when usage is exhausted in the middle of a long-distance call. Despite these limitations, the Commission should strongly encourage long-distance carriers to work with local providers in developing and deploying optional calling plans to low-income customers.

b. **Assistance with connection charges and deposits**

In the Subscribership Notice,[22] the Commission recognized that connection charges and deposit requirements may act as a barrier to promoting universal service since these charges may be unaffordable for many low-income residents thereby discouraging initiation of service.[23] The NPRM requests that parties comment on whether requiring discounted toll limiting service and reduced deposits for low-income consumers is appropriate.

TW Comm supports the Commission's proposal that links reduced deposit requirements with toll limiting services, specifically toll blocking services. However, carriers should be

[22] In re Amendment of the Commission's Rules and Polices to Increase Subscribership and Usage of the Public Switched Network, Notice of Proposed Rulemaking, CC Docket No. 95-115 (1995).

[23] Id. at 13005-06

provided with the flexibility required to determine the need for an additional deposit once a subscriber decides to remove the blocking restriction. If a provider removes blocking after providing service for only a few months, or removes blocking for customers with a history of frequent delinquent payments, the situation may warrant an additional deposit. However, if a customer made timely payments of local services for an extended period of time, a carrier may determine that the removal of long-distance blocking does not represent a risk warranting further deposit.

2. How to Implement and Who is Eligible for Support

The NPRM seeks comment on whether the existing support mechanisms targeting low-income customers should be changed as part of an overall mechanism to "ensure that quality services are available at just, reasonable, and affordable rates for low-income subscribers".[24]

The targeted support mechanisms currently funding state and federal lifeline programs have thus far been successful in ensuring that quality services are available at just, reasonable, and affordable rates to low-income consumers and thus should not be changed. Eligibility requirements for lifeline assistance are currently established by the local exchange carriers offering lifeline services or by state commissions. These determinations should remain at the state level since state administrative bodies have access to information regarding the income levels of residents as well as population characteristics and are better

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[24] NPRM, para. 65.

able to determine the specific telecommunications service needs of low-income residents in their jurisdiction.

III. Schools, Libraries, and Health Care Providers

A. A Rulemaking Proceeding is Not the Appropriate Forum to Address These Issues, an NOI Should be Initiated

In response to Congress's intent to ensure that elementary and secondary schools, health care providers, and libraries have access to basic and advanced services, the NPRM sets forth a myriad of questions to be addressed by commenting parties. The questions being posed, however are premature and should be raised in a Notice of Inquiry proceeding rather than in a rulemaking.

It is understandable that due to the limited time frame in which the FCC has to implement the mandates of the Act, it has undertaken resolution of these issues in this NPRM. However, limited information has been provided to enable a party to answer adequately and informatively the questions being raised. Thus, before parties can present reasoned analyses on these issues, information must be gathered, through an NOI, from schools, libraries and health care providers. This information must describe, in detail, the telecommunications services currently being provided and utilized by these institutions. If services are not being provided or are inadequate, additional information will be needed to determine why the market has failed and how this failure can be remedied consistent with the 1996 Act's overall goal to promote competition in the provision of communications services. Additional information will be needed on the types of advanced services these institutions will require to ensure universal access to information.

The new statute also requests that schools and libraries should obtain access to advanced telecommunications services. Thus, comments are not just being sought on the basic services that should be provided to these institutions in order to ensure all individuals have access to basic telephone service. Instead, pursuant to Section 254(b)(6) comments are being sought on what advanced services should be provided to these institutions to promote both educational goals and the availability of ubiquitous information. These are issues of first impression and thus, must be severed from this universal service proceeding and undertaken separately after a NOI has been completed.

B. FCC Must Evaluate Market Conditions Before Implementing Rules in this Proceeding

To ensure competitive neutrality, the FCC must carefully examine the current market in order to identify the services being provided to schools, libraries and health care providers. The Commission and the Joint Board must examine existing service agreements that many incumbent LECs have executed, many of which arrange for telecommunications services to be provided to educational and health care institutions.[25] These agreements will provide valuable information on the type and quality of services currently being provided by the market. States should be directed to reexamine these deals so that the FCC may accurately evaluate market conditions before implementing rules in accordance with Section 254. Moreover, once new rules have

25 See, e.g., NYNEX Performance Regulation Plan.

been implemented, these agreements may necessitate reconstruction in order to ensure competitive neutrality.

Moreover, when determining the services to be offered to schools, libraries, and health care facilities, the Commission must not presuppose that certain technologies exist. Rather, the Commission must ensure that its determinations are technologically neutral by focusing on the goals of universal service rather than on a particular technology.

In calculating the amount of the discount available to educational and health care institutions, the Commission must read Section 254(h)(B) in conjunction with Section 254(e). Section 254(h)(B) states that the discount shall be "the amount that the Commission, with respect to interstate services, and the States, with respect to intrastate services, determine is appropriate and necessary to ensure affordable access to and use of such services by such entities".[26] However, Section 254(e) provides that support received by an eligible carrier must be used only for the "provision, maintenance, and upgrading of facilities and services for which the support is intended. <u>Any such support should be explicit and sufficient to achieve the purposes of this section</u>".[27] Thus, in calculating the amount of the discount available to these institutions, the Commission must take into consideration the amount of support necessary to achieve the purposes of Section 254(e).

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[26] 1996 Act, sec. 101(a), § 254(h)(B).

[27] <u>Id.</u> § 254(e) (emphasis added).

IV. Non-Targeted Universal Support Funded by the CCLC Must be Eliminated

The 1996 Act states that federal universal service support provided to eligible carriers "should be explicit" and should be recovered from all telecommunications carriers that provide interstate telecommunications service "on an equitable and nondiscriminatory basis."[28] Currently, the bulk of the support from interstate services for universal service comes from the Carrier Common Line Charge ("CCLC"). Additional funding is derived from other interstate and intrastate services provided directly by LECs and by direct assessments to interexchange carriers. In response to arguments raised that the existing CCLC "artificially raises rates for interstate long distance usage and distorts competitive incentives in the local market,"[29] the NPRM requests commenters to address whether the CCLC is consistent with the provisions of the 1996 Act which mandate that universal service support flows "be explicit" and be recovered on a "nondiscriminatory basis" from all telecommunications carriers providing interstate service.[30] The NPRM further seeks comment on whether to continue the existing subsidy in order to preserve reduced end user common line charges, or to eliminate or reduce the subscriber loop portion of the interstate CCLC and, instead allow LECs to recover these costs from end users.[31]

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[28] Id. §254 (d),(e).

[29] NPRM, para. 113.

[30] 1996 Act sec. 101(a), §254 (d),(e).

[31] NPRM, para. 113.

The CCLC that is applied for all interstate and for many intrastate switched access minutes was established as a general support mechanism to recover that portion of the non-traffic sensitive ("NTS") common line revenue requirement that is not otherwise recovered through the SLC. This general, non-targeted support mechanism helped to achieve high rates of penetration in the United States. However, it may be that this support is no longer required since penetration rates have been recorded to be in the mid-to high 90 percent range.

A. <u>The Subscriber Line Charge Should be Increased</u>

As CCLC-funded non-targeted support is eliminated, a commensurate increase in the SLC should be implemented. This will result in better alignment of end user monthly rates with the non-traffic sensitive costs of providing end user access, while at the same time permitting interexchange access services to be priced more closely in line with incremental traffic-sensitive costs. The resulting modest increase in the SLC is unlikely to effect universal service and would be more compatible with the evolution of a competitive market. Moreover, as the Commission has previously determined, an increase in flat rate recovery of LECs' subscriber loop costs substantially stimulates demand for interstate switched services and has not adversely affected the level of subscribership.[32] This gradual realignment of a LEC's intrastate telecommunication rates with

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[32] In re MTS and WATS Market Structure; Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, <u>Recommended Decision and Order</u>, 2 FCC Rcd 2324 (1987).